AMERICAN BENEFITS COUNCIL

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Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Re: Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights (RIN 1210-AC03)

Dear Sir or Madam:

The American Benefits Council ("the Council") appreciates the opportunity to provide comments on the proposed rule published by the U.S. Department of Labor (DOL) regarding prudence and loyalty in selecting plan investments and exercising shareholder rights ("proposed regulation" or "proposal").[1] The proposal would amend DOL's investment duties regulation, which was most recently revised in 2020 by the previous administration through a pair of rulemakings.[2] The 2020 revisions had amended the investment duties regulation to incorporate in regulatory guidance for the first time standards related to environmental, social, and governance (ESG) considerations in plan investments and investment courses of action, as well as plan fiduciaries' obligations to vote proxies and exercise other shareholder rights in connection with plan investments.

[1] 86 Fed. Reg. 57,272 (Oct. 14, 2021) (to be codified at 25 C.F.R. pt. 2550).

[2] 29 C.F.R. § 2550.404a-1. In this letter, we use the term "current regulation" to refer to DOL's investment duties regulation as it exists today, which includes the amendments that were made to the regulation in 2020. References to the "2020 revisions" (or similar such terms) refer specifically to the amendments made by the previous administration's Financial Factors in Selecting Plan Investments final rulemaking and/or the Fiduciary Duties Regarding Proxy Voting and Shareholder Rights final rulemaking, as applicable.

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On the whole, we support the proposed regulation and DOL's efforts to ensure that plan fiduciaries are comfortable exercising their fiduciary duties with respect to investment-related decisions without concern that DOL's regulations require taking (or not taking) into account certain factors, such as ESG considerations. We commend DOL for its stakeholder outreach in advance of this proposal and thank Acting Assistant Secretary Ali Khawar for participating in a recent Council webinar to discuss the proposal. Many of the Council's members share the concerns with the current regulation that Acting Assistant Secretary Khawar described on that webinar. For example, while the final regulations issued in 2020[3] did respond to many of the comments that the Council and others made on the 2020 proposals,[4] the 2020 revisions created unnecessary uncertainty for fiduciaries with respect to the appropriate consideration of ESG factors and whether and how to vote proxies. The 2020 revisions also were interpreted by some as inappropriately targeting ESG factors for heightened scrutiny. Although we believe that the proposal would improve the current regulation in those and other regards, we describe below a few suggestions we have for further improvement, including removing the examples of ESG-related factors that might be material to a risk-return analysis from the text of the proposed regulation.

The Council is a Washington D.C.-based employee benefits public policy organization. The Council advocates for employers dedicated to the achievement of best-in-class solutions that protect and encourage the health and financial well-being of their workers, retirees and families. Council members include over 220 of the world's largest corporations and collectively either directly sponsor or support sponsors of health and retirement benefits for virtually all Americans covered by employer-provided plans.

NEED FOR SETTLED GUIDANCE THAT FOCUSES ON FOLLOWING A SOUND PROCESS

As the Council expressed in comments submitted when the 2020 revisions to the investment duties regulation were under consideration, the Council strongly supports the importance of plan fiduciaries acting in accordance with ERISA's duties of prudence and loyalty when making investment-related decisions.[5] Our members take those duties very seriously when acting as fiduciaries and making decisions regarding plan assets. We also share DOL's long-held view that a fiduciary may not subordinate the interests of participants and beneficiaries in their retirement income or financial benefits

[3] 85 Fed. Reg. 72,846 (Nov. 13, 2020); 85 Fed. Reg. 81,658 (Dec. 16, 2020).

[4] 85 Fed. Reg. 39,113 (June 30, 2020); 85 Fed. Reg. 55,219 (Sept. 4, 2020).

[5] Letter from Jan Jacobson, Senior Counsel, Retirement Policy, Am. Benefits Council, to Office of Regulations and Interpretations, Emp. Benefits Sec. Admin., Dep't of Labor (July 30, 2020), https://www.americanbenefitscouncil.org/pub/?ID=4FD88FCF-1866-DAAC-99FB-54FBEF16164F.

under the plan to pursue collateral objectives—this is a core view that has remained constant throughout multiple changes in administration.

ERISA takes a non-prescriptive approach with the duties it imposes on plan fiduciaries, giving fiduciaries leeway they need to determine how best to fulfill those duties in a wide variety of situations. Key to making those determinations is the fiduciary's use of a sound process. The Council appreciates DOL's efforts to take a less prescriptive approach with the proposal as compared to the current regulation, including by eliminating certain explicit requirements that DOL explains in the preamble as already being inherently accounted for by the general obligations that ERISA imposes on fiduciaries. Because meeting ERISA's fiduciary duties requires flexibility on the part of fiduciaries, it is vital that DOL's regulations or other guidance do not inappropriately restrict a fiduciary's flexibility in determining how best to meet its obligations. For these reasons, we support the proposal to the extent that it improves the current regulation in this regard. We also encourage DOL to look for additional opportunities to ensure that the investment duties regulation's focus remains on fiduciaries' need for flexibility and supporting the use of a sound, prudent process.

In addition to providing flexibility, Council members have stressed how important it is to have settled guidance for fiduciaries making investment decisions. Despite the consistency in DOL's core view as noted above, different administrations have expressed different notions over the years about what exactly that core view means with respect to a fiduciary's consideration of ESG factors and proxy voting. Those differing viewpoints were first expressed through a series of subregulatory guidance, and most recently through the 2020 revisions that resulted in the current regulation.[6] Our members generally believe that the current regulation inappropriately creates obstacles for fiduciaries' consideration of ESG factors and exercise of shareholder rights, and we are very supportive of DOL's efforts to amend the current regulation in a centered manner that ultimately tips the scale in neither direction. Although we believe that the proposal would make substantial progress in reaching that goal, our comments below include suggestions that we believe would further accomplish DOL's objective

[6] For example, with respect to plan fiduciaries' consideration of ESG-type factors, the Clinton administration released Interpretive Bulletin (IB94-1 in 1994, which addressed economically targeted investments (ETIs) that are selected in part for their collateral benefits and established an "all things being equal" test. In 2008, the Bush administration replaced IB 94-1 with IB 2008-01, which offered a more restrictive view on the consideration of ETIs. The Obama administration then replaced IB 2008-01 with IB 2015-01, which reinstated language from IB 94-1. Field Assistance Bulletin (FAB) 2018-01, subsequently released by the Trump administration, returned to the more cautionary approach of IB 2008-01. The Trump administration then undertook the development of regulatory guidance to address the consideration of ESG-type factors, proposing amendments to DOL's investment duties regulation in June 2020 and publishing final regulations in November 2020 (85 Fed. Reg. 39,113 and 85 Fed. Reg. 72,846, respectively).

and reduce the likelihood that a future administration could feel compelled once again to amend DOL's investment duties regulation.

Beyond the text of the regulation itself, we also encourage DOL to consider whether the rule's preamble and regulatory impact analysis (RIA) could be used against the proposal and to support a future administration's potential desire to revisit the investment duties regulation (assuming the proposal is finalized). For example, the RIA's discussion of certain studies that have found ESG investing results in lower returns than conventional investing could invite future scrutiny of the rule.[7] As another example, the preamble's lengthy discussion of a "substantial body of evidence" supporting the materiality of ESG factors in the assessment of investment risks and returns could be viewed by a future administration as lacking impartiality and imposing DOL's own judgments on fiduciaries—this, too, could be cited as a reason to once again revisit the investment duties regulation in the future.

With the above goals in mind of achieving regulatory stability and maintaining a focus on flexibility and ERISA's requirements to follow a prudent process, we offer below some specific comments on the proposal. The next section describes our recommendations for changes to the proposal and requests for additional clarification. Below that, we highlight our support for several specific aspects of the proposed regulation.

SPECIFIC RECOMMENDATIONS AND REQUESTS FOR CLARIFICATION REGARDING THE PROPOSAL

1. Remove the examples of ESG-related factors that might be material to a risk-return analysis from the text of the proposed regulation

The proposed regulation would add a new sentence to the section of the investment duties regulation that addresses the duty of prudence to explicitly state that a prudent fiduciary "may consider any factor in the evaluation of an investment or investment course of action that, depending on the facts and circumstances, is material to the risk-return analysis."[8] DOL has proposed to accompany that statement with a list of examples of what such factors "might include," where every example in the list relates to either climate change, governance, or workforce practices.[9] In the preamble, DOL explained that the above additions clarify and confirm that "a fiduciary may consider any factor that is material to the risk-return analysis, including climate change and

[7] 86 Fed. Reg. at 57,290.

[8] Proposed § 2550.404a-1(b)(4).

[9] *Id.* § 2550.404a-1(b)(4)(i)-(iii).

other ESG factors."[10] DOL further adds that the intent of these additions is to "establish through examples that material climate change and other ESG factors are no different than other 'traditional' material risk-return factors and to remove prejudice to the contrary."

Due to the uncertainty that the current regulation created regarding whether and the extent to which fiduciaries may consider ESG factors in investment decisions, we appreciate DOL's intent in adding the above statement and accompanying examples. While we understand that DOL means for the examples to be merely illustrative, we believe that a better approach would be to remove the examples and have the proposed new sentence in Paragraph (b)(4) stand alone as one of the principles a fiduciary should follow in meeting its duty of prudence.[11] The reasons for our recommendation are as follows:

- Myriad other factors, in addition to those relating to climate change, governance, and workforce practices, may be important for a prudent fiduciary to take into account as being material to a risk-return analysis. Singling out only ESG-related factors as examples within the regulatory text could variably be viewed as emphasizing, distinguishing, or even requiring the consideration of ESG-related factors in a risk-return analysis as compared to other factors. Such a result would work against DOL's goal of clarifying that fiduciaries should incorporate material ESG-related factors into their decision-making process in the same manner as any other material factor.

- The proposed new sentence stating that fiduciaries may consider any factor material to the risk-return analysis is sufficiently clear on its own in communicating DOL's intent with respect to how fiduciaries may use ESG-related factors in investment decisions.

- The inclusion of only ESG-related factors within the regulation could be inappropriately targeted by plaintiffs' attorneys and result in unnecessary litigation and expense for plan sponsors.

In light of the above concerns, as noted, we recommend removing the examples from their proposed location in Paragraph (b)(4). Several of the Council's members have suggested that including the examples in the preamble to the final rule would be a more appropriate and helpful location. Other members have suggested providing the examples separately elsewhere in the regulation so that they are not directly embedded within the core of the key provisions addressing the duty of prudence and to make it

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[10] 86 Fed. Reg. at 57,288.

[11] Removing the examples from proposed Paragraph (b)(4) would also result in removing their incorporation by reference in paragraphs (c)(2) and (d)(2)(ii)(A), which we believe is also an appropriate result and would further contribute to protecting the regulation against attacks.

more clear that they are intended to serve merely as examples. Regardless of the approach, we believe that removing and/or relocating the examples is important to taking a more principles-based approach and decreasing the likelihood that the regulation is revisited yet again in the future, and for ensuring that a fiduciary may consider any factor the fiduciary itself determines is relevant to the risk-return analysis. As noted above, achieving consistency in DOL's guidance is very important to the retirement plan community after having to adjust multiple times over the years to the back and forth in DOL's previous guidance.

2. Proposal to introduce a new DIA disclosure requirement when collateral benefits are taken into account

The proposed regulation would provide that, if a plan fiduciary makes an investment selection based on collateral benefits in the case of a designated investment alternative (DIA) for an individual account plan, the plan fiduciary "must ensure that the collateral-benefit characteristic of the fund, product, or model portfolio is prominently displayed in disclosure materials provided to participants and beneficiaries."[12] DOL states in the preamble that it expects this disclosure requirement would often be fulfilled by using the 404a-5 disclosure.[13]

Some Council members have noted that existing disclosure rules are adequate in ensuring that participants are given sufficient investment information, including in the case that collateral benefits are taken into account when selecting among different investment options. We have also heard concern that requiring the disclosure of certain factors over others could be confusing to participants and undermine the broader goal of developing a more neutral, sustainable regulation.

In the event that DOL finalizes the proposed new DIA disclosure requirement, then some of our members have suggested that it would be helpful for DOL to provide some examples or models to give fiduciaries a sense of what the disclosure could look like. Although we appreciate that the proposal takes a more general and flexible approach in describing the disclosure requirement, additional clarity—including through the provision of examples or models—would be helpful. In particular, more information regarding what it means to "prominently" display the collateral-benefit characteristic would be helpful, including the relative prominence of this information as compared to other important investment-related disclosures. These sorts of examples in the preamble might allay fears that the disclosure would be misunderstood or overwhelm other important information a participant should consider when choosing investments, including asset class, historical return, and fees. Some of our members, however, do not

[12] Proposed § 2550.404a-1(c)(3).

[13] 86 Fed. Reg. at 57,280.

see the need for models and have suggested that fiduciaries should be able to leverage existing disclosures, including fund disclosures.

3. Request for clarification regarding fiduciaries' ability to consider broader range of information in selecting DIAs, including participant preferences, under the proposal

We generally support DOL's proposal to refocus the investment duties regulation on factors that are relevant to a risk-return analysis. We are concerned, however, that the proposal does not go far enough to make clear that plan fiduciaries of defined contribution plans should be able to appropriately consider participant preferences, especially with respect to factors that are not easily quantifiable. The current regulation makes clear that a fiduciary is not prohibited from considering or including an investment as a DIA solely because the fund, product, or model portfolio promotes, seeks, or supports one or more non-pecuniary goals, provided that that the requirements of the regulation are otherwise satisfied and the investment is not a qualified default investment alternative (QDIA). This language would be removed by the proposal in favor of the "equally serve the financial interests" standard (as discussed below) with a special disclosure for DIAs.

While unintentional, we believe the new formulation might be read to preclude the prudent consideration of factors that are not tied to risk or return directly but would be considered as part of a prudent process for selecting DIAs. For example, many fiduciaries will reduce the number of investments to avoid "choice overload" or will consider factors that reflect participant preferences. Such factors could include the reputation or tenure of the investment manager. As another example, a fiduciary will often consider funds with different investment styles, such as growth or value; this choice was made not directly from a judgement one is inherently better but to meet the desire of participants to have that choice. Although we understand that the proposal would allow fiduciaries to consider participant preferences when selecting an investment for its collateral benefits under the revised "equally serve" test, fiduciaries may at times find it prudent and relevant to take nonquantifiable factors into account at the front end of their analysis (that is, before applying the "equally serve" standard). During the Council's recent webinar with Acting Assistant Secretary Khawar, he expressed his view that the proposed regulation would offer a number of ways for fiduciaries to take such items into account. We would appreciate DOL's confirmation of this point together with examples of the different ways in which the proposed regulation would accommodate the consideration of relevant participant preferences and nonquantifiable factors. Some of our members have further suggested that it would be helpful to have a safe harbor for participant-directed plans so that fiduciaries can respond to participant demands for particular types of investments or investments with particular features by including such an investment within a diversified lineup without being second-guessed solely on the basis of how that fund compares to another fund with a different investment style.

4. Request for clarification regarding the need to consider ESG factors

The proposal would amend the current regulation's duty of prudence safe harbor to provide that a fiduciary's consideration of the projected return of the portfolio relative to the funding objectives of the plan "may often require an evaluation of the economic effects of climate change and other [ESG] factors" on the investment or investment course of action.[14] This phrasing, together with certain comments made by DOL in the preamble and elsewhere regarding its view of the importance of considering climate change, could be viewed as suggesting that there are situations in which DOL believes that ESG factors *must* be taken into account.[15] We think it is important for DOL to make clear that there are many situations in which a fiduciary, in its judgment, simply does not consider ESG factors because the fiduciary believes other factors are more relevant to its analysis. A simple example is the use of index funds—when a plan invests in an index fund, by definition the plan is choosing to make no judgments about the operating companies in the index but is trying to achieve the returns of the index net of fees. We believe it would be inconsistent with the spirit of the proposal and inconsistent with ERISA to mandate that fiduciaries always take into account any particular factor as part of their prudent analysis, and it is important that DOL confirm this point and not include the "may often require" language in the text of the final regulation.

SUPPORT FOR SPECIFIC ASPECTS OF THE PROPOSAL

1. Proposal to eliminate provisions in the current regulation that single out ESG factors

The current regulation includes several provisions that the Council believes inappropriately single out ESG factors and subject them to increased scrutiny and added restrictions. Specifically, these include:

- the prohibition on an investment fund, product, or model portfolio from being added or retained as, or as a component of, a QDIA if its investment objectives or goals, or its principal investment strategies, "include, consider, or indicate the use of one or more non-pecuniary factors";[16]

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[14] Proposed § 2550.404a-1(b)(2)(ii)(C).

[15] For example, DOL states in the preamble to the proposal that "the proposal makes clear that climate change and other ESG factors are often material and that in many instances fiduciaries should consider climate change and other ESG factors in the assessment of investment risks and returns," and "the Department believes that consideration of the projected return of the portfolio relative to the funding objectives of the plan not only allows but in many instances may require an evaluation of the economic effects of climate change." 86 Fed. Reg. at 57,276.

[16] 29 C.F.R. § 2550.404a-1(d)(2)(ii).

- a separate provision clarifying the general application of the duties of prudence and loyalty with respect to the selection or retention of DIAs;[17] and

- a special documentation requirement that applies if a fiduciary uses non-pecuniary factors as a tie-breaker.[18]

The proposed regulation would eliminate each of the above items. In the preamble, DOL generally explains these provisions as being unnecessary in light of the general duties that ERISA imposes on fiduciaries and other existing guidance. For example, DOL states in the preamble that the special documentation requirement that applies when non-pecuniary factors are used as a tie-breaker is unnecessary because fiduciaries are already subject to a general prudence obligation and commonly document their investment selections due to that obligation.[19] With respect to elimination of the restriction on QDIAs, the preamble notes the protective standards that separately exist in DOL's QDIA regulation.[20]

For the reasons described by DOL, we **strongly support** the removal of provisions in the current regulation that unnecessarily single out ESG factors. Removing these provisions would help return the focus of the investment duties regulation to the use of a prudent process and restore the flexibility fiduciaries need to apply such process in different contexts. It would also counteract the chilling effect that these provisions have had on fiduciaries' consideration of ESG factors.

2. Proposal to reframe the tie-breaker test to reflect that many investments may equally serve a plan

Under the current regulation, a fiduciary that cannot distinguish investment alternatives on the basis of pecuniary factors may use non-pecuniary factors as the deciding factor.[21] The proposal would reframe the applicable standard for that tie-breaker test so that, if a fiduciary prudently concludes after conducting a risk-return analysis that competing investments or investment courses of action "equally serve the financial interests of the plan over the appropriate time horizon," then the fiduciary is not prohibited from making the selection based on collateral benefits other than investment returns.[22]

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[17] *Id.* § 2550.404a-1(d).

[18] *Id.* § 2550.404a-1(c)(2)(i)-(iii).

[19] 86 Fed. Reg. at 57,279.

[20] *Id.* at 57,279-80.

[21] 29 C.F.R. § 2550.404a-1(c)(2).

[22] Proposed § 2550.404a-1(c)(3).

We support this proposed change as an improvement over the current regulation's more rigid tie-breaker test. Our members generally believe that the proposal is more reflective of and responsive to the situation that fiduciaries can find themselves in when making investment-related decisions. That being said, we would emphasize that, when a fiduciary is evaluating investment opportunities, there are often many investments that would be prudent to select. As long as the selection of any particular investment is consistent with a prudent process, then any number of investments may be chosen.

3. Proposed proxy voting-related changes

The proposal would make several changes to the current regulation's provisions that pertain to a fiduciary's duties with respect to voting proxies and the management of other shareholder rights. These changes include (1) removing the explicit requirement that fiduciaries maintain records on proxy voting activities and other exercises of shareholder rights, and (2) removing the requirement that a fiduciary prudently monitor the investment manager or proxy voting firm to which the fiduciary delegated authority to vote proxies. We support these changes.[23] Similar to many of the proposed ESG-related changes, we believe that the proposed proxy voting-related changes would remove the more concerning aspects of the current regulation that could be viewed as requiring fiduciaries to take action that is different than—and potentially inconsistent with—the action required when following a prudent process. For example, maintaining records and monitoring service providers are activities that fiduciaries already typically engage in as part of following a prudent process, but there may be instances where a prudent fiduciary determines that such actions are not necessary or would be inconsistent with the fiduciary's duties. As with the proposed removal of similar such provisions that are part of the proposed ESG-related changes (discussed above), removing these proxy voting-related provisions would help return the focus of the investment duties regulation to the use of a prudent process and restore needed flexibility for fiduciaries.

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We appreciate DOL's efforts to revisit and revise those aspects of the current regulation that have created uncertainties and presented challenges for plan fiduciaries as they strive to meet their fiduciary duties under ERISA when making investment-related decisions. Thank you for the opportunity to provide our view and suggestions. If you would find it helpful to discuss any of these matters with us, please contact me at 202-289-6700 or ldudley@abcstaff.org.

[23] Along with supporting these changes, one Council member pointed out that, in addition to addressing pooled investments in paragraph (d)(4)(ii), the regulation should also make explicit that a plan can accept an investment manager's own proxy voting policy when hiring the investment manager to manage a separate account.

Sincerely,

Lynn D Dudley

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